Essentials: What Every Claim Adjuster Should Know About Bad Faith

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Many adjusters don't have a clear understanding of what constitutes insurance bad faith. The tort of common law bad faith is an outgrowth of judicial concern that the insurance industry could employ improper economic motivation to delay or refuse to pay valid insurance claims.

There are several standards used to describe the requirements to establish bad faith misconduct. In a majority of states bad faith involves a combination of negligence and intentional misconduct.

Regarding the negligence aspect, the question centers upon whether the insurance company acted unreasonably towards its insured. This part of the analysis is based upon a simple, objective, negligence standard. The second aspect of bad faith is concerned with whether the insurance company acted knowing that it was being unreasonable and by proceeding forward with the conduct purposefully decided to be unreasonable. In a majority of states, both of these elements must be established before a claim for bad faith will be successful.

Where the insurance company acts reasonable there can be no bad faith in the majority of states. Mere negligence or inadvertence is not sufficient to establish a claim for bad faith. One court has observed:

> Insurance companies, like other enterprises and all human beings, are far from perfect. Papers get lost, telephone messages misplaced, and claims ignored because paperwork was misfiled or improperly processed. Such isolated mischances may result in a claim being unpaid or delayed. None of these mistakes will ordinarily constitute a breach of the implied covenant of good faith and fair dealing …"

Rawlings v. Apodaca, 151 Ariz. 149, 157, 726 P.2d 565, 573 (1986). The following states utilize the standard described above which requires negligence and knowing

unreasonableness: Arizona, Colorado, Iowa, Kentucky, Mississippi, Nebraska, Nevada, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Texas, Vermont, Wisconsin, and Wyoming.

A few states use a negligence standard which requires a claimant to show that the insurance company's refusal to honor its contractual obligation was without any reasonable justification. The ultimate question under this standard is whether, at the time the insurance company denied the claim, there existed a set of facts or circumstances known to the insurance company which created a bona fide dispute and therefore a meritorious defense to the claim. Under this type of negligence standard, the insured need not show that the insurance company had a conscious awareness of wrongdoing or that it engaged in unjustifiable conduct, nor that the company had an evil motive or intent to harm the insured. Instead, any unreasonable delay in payment of benefits or a decision not to pay a claim may be sufficient to support a claim for bad faith. The courts in Delaware, Hawaii, Utah, Virginia and Washington have utilized this negligence standard.

The state of Virginia utilizes a comprehensive list of criteria to determine whether an insurance company has committed bad faith. In evaluating whether an insurance company has committed bad faith in Virginia, the law requires consideration of "whether reasonable minds could differ in the interpretation of policy provisions defining coverage and exclusions; whether an insurer has made a reasonable investigation of the facts and circumstances underlying the insured's claim; whether the evidence discovered reasonably supports a denial of liability; whether it appears that the insurer's refusal to pay was used merely as a tool in settlement negotiations; and whether the defense the insurer asserts at trial raises an issue of first impression or a reasonably debatable question of law or fact." *Nationwide Mutual Ins. Co. v. St. John*, 259 Va. 71, 524 S.E.2d 649, 650-51 (2000).

In all states a plaintiff must prove that the insurance company's claim professional did something more egregious than make a simple mistake.

The remaining states have adopted various standards for determining whether an insurer and its claim professionals have committed insurance bad faith. As an example,

in Arkansas, bad faith occurs when an insurance company engages in “affirmative misconduct …without a good faith defense,” that is “dishonest, malicious and oppressive in an attempt to avoid its liability under an insurance policy.” *Aetna Cas. & Surety Co. v. Broadway Arms Corp.*, 281 Ark. 128, 664 S.W.2d 463, 465 (1984). The insurer’s conduct in Arkansas must be “carried out with a state of mind characterized by hatred, ill will, or a spirit of revenge.” *See, e.g., Columbia National Ins. Co. v. Freeman,* 347 Ark. 423, 64 S.W.3d 720 (2002).

In Louisiana, bad faith requires proof that the insurance company’s conduct was “arbitrary, capricious or without probable cause.” The phrase “arbitrary, capricious and without probable cause” has been found to be synonymous with term “vexatious.” In order to establish a vexatious refusal to pay, the insured must prove an unjustified refusal to pay without reasonable or probable cause or excuse. *Louisiana Maintenance Services, Inc. v. Certain Underwriters at Lloyd’s of London*, 616 So.2d 1250 (La. 1993). In Louisiana, more than mere negligence or inadvertence is necessary to establish bad faith. *Coker v. Morris*, 855 So.2d 916 (La. App. 2nd Cir. 2003).

In Massachusetts, in order to establish bad faith, there must be a showing of conduct that is “immoral, unethical, oppressive, or unscrupulous” which “causes substantial injury.” The conduct must rise to the level of “rascality that would raise the eyebrow of someone inured to the rough and tumble world of commerce.” *Linkage Corp. v. Trustees of Boston University*, 425 Mass. 1, 679 N.E.2d 191 (1997).

The North Carolina courts have established a three-prong test for party bad faith which requires a showing of: (1) a refusal to pay after recognition of a valid claim; (2) bad faith, *i.e.,* a decision not based on honest disagreement or innocent mistake; and (3) aggravating conduct such as fraud, malice, gross negligence, insult, rudeness, oppression, or wanton and reckless disregard of rights. *Lovell v. Nationwide Mutual Ins. Co.*, 108 N.C.App. 416, 424 S.E.2d 181 (1993).

When the standards used by each state are carefully analyzed, mere mistake or inadvertence is insufficient to establish bad faith. Upon close examination, bad faith requires some degree of affirmative and intentional misconduct or knowing unreasonableness.

In the daily discourse of claim handling, file diaries can be missed or overlooked, and delays can occur without purpose or intent. Sometimes the best defense in a bad faith lawsuit is to document, with candor, lapses or mistakes that have occurred in the claim process. As an example, in one claim file this author recently reviewed there was a two and one-half month gap in the claim notes where no activity had occurred on the claim. The claim adjuster candidly documented that the lack of activity on the file was a mistake and that she had simply missed the file diary. As with many honest mistakes, the claim notes did reveal greater vigilance after the mistake had been admitted.

Given the above standards that are used to decide whether bad faith has occurred in the various states, it is important that each adjuster document populate their claim file entries with descriptions of their thought process in processing the claim forward. As an example, instead of saying “requested additional records,” it would be better for the claim adjuster to state, “requested additional records predating the accident because of the question of preexisting degeneration in the lumbar spine.” Explaining in the claim note entry why something may be of significance or meticulously documenting follow up communications with claimant’s counsel which help explain the delay that is occurring can be invaluable allies in any bad faith lawsuit because of the claim note entry’s ability to explain on a contemporaneous basis what was happening and why it was happening.

Each claim representative should consider the above standards when formulating a claim note entry explaining a significant issue or development in the claim process. Delays should be explained. The need for additional medical documentation should be explained with a description of why there is a need for additional records linked to a specific medical condition. A simple claim note indicating that the file has been checked to see if plaintiff’s counsel has provided the additional information requested can be significant in demonstrating diligence and reasonable delay.

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